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SUBJECT: DOMINICAN ELECTRICITY SERIES #2: INSISTING ON
CONTRACT RENEGOTIATION

REF: A. 06 SANTO DOMINGO 3285

[1](#)B. USAID STUDY: ANALYSIS OF THE SUSTAINABILITY OF
THE ELECTRICAL POWER SECTOR

(SBU) 1. This is the second cable of a series on the
politics surrounding the electricity sector and why politics
and not economics is the cause of the electricity crisis in
the Dominican Republic.

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INSISTING ON CONTRACT RENEGOTIATION
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(SBU) On October 18, President Fernandez along with vice
chair of the parastatal electricity company CDEEE Radhames
Segura formally asked private generators to renegotiate their
financial contracts with the government. Fernandez came
across as the good cop and Segura as the bad cop. The
generators' reaction, expressed to econoff in private, ranged
from indifference to outrage.

(U) Fernandez spoke eloquently to the CEOs of the private
generators of the need for the government and the private
sector to work together in an effort to reduce electricity
prices. Segura, in contrast, started off his remarks by
asserting that the contracts were not sustainable. He
pressed the CEOs and other private sector representatives to
renegotiate but offered companies no incentives to do so.
Segura ended the meeting with a request for private
generators to formulate a proposal to start the renegotiation
process. He advised them that the government would do
everything in its legal power to renegotiate the contracts
with the generating companies. A week later Segura requested
the generators to turn in their proposals to the parastatal
Dominican Corporation of Electricity Companies (CDEEE) by
November 8.

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BACKGROUND
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(U) In the mid-1990's in an effort to attract foreign
investment in the electricity sector, the first Fernandez
administration negotiated a power purchasing agreement (PPA)
with private generating company Smith-Enron (now Ashmore)
that included a "take or pay" provision for installed
capacity. This means that the government pays the generators
monthly installments just for being there, ready to generate

electricity when needed. Later, after the destructive passage in 1998 of Hurricane George, the government negotiated a similar PPA with Cogentrix, another private generating company. The CDEEE's view is that the government agreed to onerous terms because of the imperative to maintain the additional level of installed capacity.

(U) In 1999 the Fernandez administration embarked on a privatization ("capitalization") program for the electricity sector. It sold to private firms 50 percent of the shares of each of the three regional electricity distribution companies, as well as 50 percent of the two regional generation companies.

THE MADRID ACCORDS

(SBU) Two years later, in an effort to lower the contract prices for electricity, the Mejia administration and most large private generators, except Smith-Enron and Cogentrix, met in Madrid and negotiated a deal whereby electricity tariff rates would be reduced in return for an extension of the time period of the contracts. These Madrid Accords

extended contracts to 2016. The Accords specify a pricing mechanism benchmarked to the price of fuel. The subsequent rise in the price of fuel brought a commensurate rise in electricity tariffs, a fact that has caused much consternation among CDEEE's hardliners. CDEEE staff delivered a lengthy analysis in early 2006 arguing that certain of the formula's variables should not have been tied to fuel prices.

(U) It is only fair to note that the private generators have not simply sat back on their leather couches. Since 1999 the private sector has invested more than USD 1.5 billion in the electricity sector, (Of this, the commitment of AES is close to a billion dollars.)

(SBU) Last year in an evident initiative to increase pressure on generators, the government announced the awarding of contracts to a Chinese-Dominican firm and an Arab-Dominican firm to build four 150 MW coal-fired generating plants. It appears that to date these dubious consortia have been unable to secure the necessary financing.

(SBU) Private generators remain suspicious of Segura's call to renegotiate the contracts. They take scant comfort in the fact that contracts provide the right to invoke international arbitration in case of breach of their terms. Both Cogentrix and Smith-Enron sat out the Madrid Accords, and as of October 26 their representatives confirmed to econoff they have no plans to renegotiate. Cogentrix is busy trying to sell to Basic Energy the shares currently owned by Goldman Sachs, while Smith Enron is busily updating its new owners, Ashmore, on its activities. AES and EGE Haina plan to talk strategy with their respective headquarters. Managers at other generation plants is preparing positions.

WORLD BANK SECTORAL PROGRAM -- UNDISBURSED

(SBU) In 2002 the Mejia administration asked USAID to perform a study on the reform process of the Dominican electricity sector. U.S. firm Advanced Engineering Associates International, completed the study in early 2003, (reftel B). The World Bank referred to this study in drawing up a USD 150 million loan for the electricity sector. The loan included among disbursement conditions specific goals for improved percentages of collections and the cost-recovery index (CRI) by the distributors, improved management at the distribution centers, and legislation to criminalize the act of stealing electricity. In 2004-2005 the CDEEE complied with certain World Bank requirements by hiring two foreign experts to manage the two government distribution companies; neither has managed to turn a company around. Although the legislative process to criminalize the act of stealing electricity is moving forward (reftel A), the levels of collection and the CRI are not. To date the Bank has not disbursed any funds.

(SBU) Ahead of Fernandez's October 25 call on President Bush, Dominican presidential staff had communicated the President's desire to get the USG to persuade the Bank and other financial institutions to "be more flexible" on conditionality for lending to the country. Press reports indicate that Fernandez made the same pitch to the World Bank president.

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A SUCKING CHEST WOUND
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(SBU) In 2000, 2002 and 2005 the World Bank ranked the ten countries with the highest electricity losses. Deteriorating Dominican results moved the country from 9th, to 7th, to 4th worst in the world. As of June, 2006, figures suggest that the system's overall distribution losses due to theft and technical inefficiencies were 38 percent.

(SBU) At no time over the last 30 years has the Dominican Republic been able to supply a stable flow of electricity. This has been due mainly to mismanagement, corruption and theft. Studies by USAID and, more recently, by the Adam Smith Institute confirm this analysis.

(U) The government controls the transmission lines, the hydroelectric plants, and, since President Mejia's buy-out in late 2003 of Spain's Union Fenosa, two of the three distribution companies and 49 percent of the third. Distributors are responsible for collecting payments for electricity consumed by the government, by businesses, and by households.

(SBU) The 1999 capitalization effort conceived by Technical Secretary to the President Temistocles Montas was never

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completed. Montas, holding the same position in the current administration, opposes the current renegotiation strategy as well as Segura's attempt to gain more control of the sector. Sources both in the private sector and in the government say that political actors believe the sector is too important to

privatize. U.S. firm AES comments that the government-controlled portions of the electricity sector produce a cash flow equivalent to a billion U.S. dollars a year.

(SBU) One reality is that electricity supply is used as an electoral campaign tool. Just before elections, voters can expect to be treated to electricity 24/7. Political appointees of the administration are positioned throughout the government-controlled portions of the electricity sector. The administration is pledged to provide subsidies that constitute roughly 21 percent of the cost of a kilowatt hour (KWH), according to private sector sources.

(SBU) Studies from the private sector assert that if the government could stop the subsidy program and reinvest instead in their distribution infrastructure, the price of a KWH could decrease from 29 cents to 17 cents. There is no prospect of this. President Fernandez has pledged to continue the subsidy program.

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RENEGOTIATION AS JUST ANOTHER BAND-AID
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(SBU) The methods of the Fernandez administration during its two years in office have proven to be little more than promises of band-aids to a patient with a sucking chest wound. Renegotiation, forced or otherwise, could send a very bad message to potential foreign investors.

(SBU) Technical Secretary Montas predicts that subsidies required for the sector may rise as high as USD 900 million next year - - but neither the political authorities nor the distribution companies have shown the will to enforce the

law, which would be the first, necessary step toward health for the sector. And the inevitable PRD opponent to Fernandez for the 2008 presidential election, Miguel Vargas Maldonado, has been promising that he can fix the sector, by gradually reducing subsidies. But then, talk is cheap when one has no responsibility for the mess.

¶2. (U) Drafted by Chris Davy.

¶3. (U) This report and extensive other material can be consulted on our SIPIRNET site,
<http://www.state.sgov.gov/p/wha/santodomingo/> .

HERTELL